INTERNATIONAL TRADE - 15.04.2021

1. International Trade Theory
2. International Trade Policy
3. Balance of Payments ~~& Foreign Exchange Aspect.~~
4. Foreign exchange

(1, 2) when 2 countries are trading - trade theories

(3, 4) macroeconomic theories; open economy.

International Trade Theory

- Adam Smith's Theory of Absolute Advantage
- David Ricardo's Theory of Comparative Advantage
- Heckecher-Ohlin Theory

Adam Smith's Theory of Absolute Advantage

Acc. to Adam Smith, trade b/w 2 nations is based on absolute advantage — when one nation has more efficiency (or has an absolute advantage over the other nation) in production of one commodity, then both nations can gain by each specialising in the production of the commodity of its absolute advantage and exchanging a part of its output with the other nation for the commodity of its absolute disadvantage. By this process, resources are utilised in the most efficient way & the output of both commodities will rise.

This increase in output of both commodities measures the ~~need~~ gain from specialisation available to be divided between the 2 nations through trade.

→ Merchantilism believed that one nation will gain only at the expense of the other nation and advocated strict government control of all economic activity and trade.

→ Adam Smith believed that all nation will benefit from free trade and strongly advocated a policy of laissez-faire.

Free trade would cause world resources to be utilised more efficiently and would maximise world welfare.

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Concept by Adam Smith